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SUBJECT: THE VIEW FROM BERLIN: NO EUROPE-WIDE BAILOUT BUT
COORDINATION ONGOING

¶1. (SBU) SUMMARY. In a meeting with Deputy Secretary of the Treasury Robert Kimmitt on October 9, Thomas de Maiziere, Head of the Federal Chancellery, signaled the possibility of greater European coordination following the upcoming EU summit. The Chancellery is critical of the way the UK and Ireland rolled out their bank rescue plans. Germany does not intend to pay for a Europe-wide bailout that might give member states a green light to offload bad assets. De Maiziere hoped the U.S. rescue plan would have clear, unequivocal rules to restore market confidence. He expressed some skepticism of Steinbrueck's recently announced 8-point plan. END SUMMARY.

¶2. (SBU) Kimmitt reported that U.S. authorities - the Federal Reserve, Treasury, SEC, other regulators - were coordinating their actions, but it was now time for greater international coordination. The G7 and G20 finance minister meetings in Washington this weekend would be a good occasion to do so. Finance ministers need clear lines of communication and coordination to guide future collaboration, where appropriate. They will focus on core principles for dealing with the current financial turmoil, namely:

- enhancing liquidity (to be handled by monetary authorities);
- strengthening financial institutions;
- preventing market abuse; and,
- protecting retail savers.

¶3. (SBU) De Maiziere agreed and added that now was not the time to diagnose the root causes of the crisis. There would be time for that later. States need now to rebuild trust and confidence in the markets, though too much should not be promised to investors, firms and others. Europe as a whole needs to change its accounting rules in the next 10 days, when banks' quarterly reports come out, to bring them in line with U.S. accounting standards. Otherwise, countries will have to resort to national solutions, while coordinating with each other.

¶4. (SBU) In reference to the October 7, 2008 meeting of EU finance ministers in Luxembourg, De Maiziere noted EU agreement on supporting banks whose failure could cause systemic risk. Yet Germany would not "put a bag of money in the middle of Europe for all to grab" as a way of mitigating risk, he added, as it would give member states a green light to offload bad assets. Though they officially welcomed the UK and Irish bank rescue plans, the Germans are not pleased with the way they were announced. They noted that Gordon Brown had not mentioned the UK plan to Merkel at the recent summit in Paris.

¶5. (SBU) With regard to the Troubled Asset Relief Program (TARP), Kimmitt indicated that Treasury will likely not be making its first purchases until November. De Maiziere hoped the \$700 billion U.S. rescue plan would have clear, unequivocal rules to encourage market confidence. Institutions will need to be looked at again after the

financial crisis has passed, and new international rules should be considered. There must also be careful preparation for all multinational meetings addressing the crisis; inconclusive meetings could actually contribute to a further loss of market confidence. As this weekend's meetings in Washington were previously scheduled, he had no such concerns about it.

¶16. (SBU) In response to a question by De Maiziere, Kimmitt informed him that the SEC's ban on short-selling expired on October 8. He also explained that the SEC did not change accounting rules, as some recently alleged. Rather, the regulatory agency clarified existing rules with regard to classification, noting existing flexibility.

¶17. (SBU) Kimmitt praised the Transatlantic Economic Council (TEC), created under the Germany EU Presidency, and highlighted the important role it had played in bringing U.S. and European accounting standards closer together. He saw the TEC as the single most important transatlantic economic initiative in years, and hoped the Germans would encourage other Europeans to continue supporting it. De Maiziere pledged that Germany would do so, but was unable to confirm whether Germany would play a major role in sustaining the TEC.

¶18. (SBU) Some have characterized Germany as pro-regulation and the U.S. anti-regulation, said Kimmitt. In fact, the distinction was simplistic. Analysis in the U.S. shows that no market participants - mortgage originators, banks, credit rating agencies, regulators, or investors - performed well prior to the financial crisis. The crisis started in the most regulated part of the U.S. financial services sector: banks (and not hedge funds). More regulation in the future may be needed, he suggested, but it should be designed in a way that does not stifle innovation.

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¶19. (SBU) Kimmitt said that U.S. authorities are often unsure of how to coordinate with Europe, whether via EU institutions, bilaterally or otherwise. De Maiziere acknowledged the diversity of key European actors - ECB Chief Jean-Claude Trichet, Luxembourg's Prime Minister Jean-Claude Juncker, French President Nicolas Sarkozy, various EU Commissioners - but noted the EU could have more unity following the upcoming, previously scheduled, EU Summit. Commenting on Steinbrueck's recent 8-point proposal for financial market rules, Kimmitt hoped there would not be too many different plans with too many points. Some of Steinbrueck's points were in line with U.S. thinking, but others could wait until after the current fire had been put out. De Maiziere mildly criticized Steinbrueck's plan, noting it did not indicate priorities, and contained elements that were short-term and long-term, institutional and personal. He was not certain whether Germany had raised it with the EU yet.

¶110. (SBU) Kimmitt felt the G20 was an appropriate group to work with on the crisis, especially since it would reveal Chinese, as well as Japanese, perspectives. Kimmitt characterized U.S.-Asia interaction on the financial crisis to this point as constructive, though more "tactical and operational" than "strategic and philosophical." The U.S. has been working with Asian countries to ensure they had information they needed to reach decisions, including the continued purchase of sovereign debt following the federal takeover of Fannie Mae and Freddie Mac.

¶111. (SBU) Kimmitt raised the danger the financial crisis posed to fragile emerging economies such as Ukraine and Pakistan. Pakistan currently has less than two months of import cover. A collapse of the Pakistani economy could lead to unrest and play into the hands of the Taliban. This could cause additional security concerns for U.S. and German troops in Afghanistan. Pakistan needs an IMF package; the World Bank is also prepared to help, and the Asian Development Bank has already pitched in. Although President Zadari seems to understand this, it is politically difficult for Pakistani leaders to be seen bowing to pressure from the IMF or western governments. Kimmitt commented that he saw an active future for the IMF, but further reform is need to ensure that big emerging economies like Brazil and India are engaged.

¶112. (SBU) In response to a question by De Maiziere, Kimmitt noted

that in times of economic turmoil, investors often put their money in industrial countries' bonds or in commodities like gold, but were less inclined to do so with oil, whose price is particularly sensitive to supply and demand forces, and hence volatile. Despite their huge Sovereign Wealth Funds, countries like Kuwait and Saudi Arabia are struggling to keep up services in the context of falling oil prices, and are reported to be considering repatriation of funds invested abroad in order to do so.

¶13. (SBU) Kimmitt said the U.S. appreciated Germany's support on implementing UN Security Council resolution 1803 on Iran, particularly by designating Bank Melli. Western countries need to make sure Iran does not have the opportunity to illegally transfer funds for its weapons program while all eyes are averted by the financial crisis. Strong action within the EU supports the argument in favor of multilateral action as opposed to Congressional proposals that would force foreign companies to choose between trading with the U.S. or with Iran. He also referenced recent proposals by the U.S., French and British, respectively:

- Expanding sanctions on financial services to include insurance;
- Tightening export controls within the EU on oil refining technology; and
- Tightening export controls within the EU on liquefied natural gas technology.

¶14. (SBU) Kimmitt remarked that Russian and Chinese banks were honoring Security Council resolutions against Iran, despite their government's political rhetoric. He added that years ago, U.S. sanctions against the Soviet Union often had a more negative impact on the transatlantic relationship than on the Soviets because of the unilateral nature of extraterritorial sanctions. Hence, today's sanctions are targeted and multilateral.

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